United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

To be argued by
RAYMOND P. O'KEEFE

76-7616

United States Court of Appeals
For the Second Circuit

ROSALIE M. ARLINGHAUS, Executrix of the Will of FRANK H. ARLINGHAUS and ROSALIE M. ARLINGHAUS, individually,

Plaintiff-Appellant,

against

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Defendants-Appellees,

and

MIRIAM PEPPER and SIDNEY PEPPER,

Defendants.

APPELLEES' BRIEF

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United States Court of Appeals

For the Second Circuit

Rosalie M. Arlinghaus, Executrix of the Will of Frank H. Arlinghaus, and Rosalie M. Arlinghaus, individually,

Plaintiff-Apellant,

against

J. Richmond Ritenour and John J. Lipsky,

Defendants-Appellees,

and

Miriam Pepper and Sidney Pepper,

Defendants.

APPELLEES' BRIEF

Statement of the Issue Presented for Review

Did the trial court err in finding that all material infor mation concerning Teleservice was known to plaintiff, either directly or indirectly, where the officer-defendants routinely reported all such information to (a) the board of directors, one of whom was the plaintiff's brother-in-law and advisor and (b) plaintiff's attorney?

Statement of the Case

Rosalie M. Arlinghaus ("Plaintiff"), individually and as Executrix of the Estate of Frank H. Arlinghaus, plaintiff's husband, sued to rescind a sale by plaintiff of shares

of stock in Modern Teleservice, Inc. ("Teleservice") to defendants J. Richmond Ritenour ("Ritenour"), John J. Lipsky ("Lipsky") and Miriam Pepper, wife of defendant Sidney Pepper ("Pepper").

With respect to defendants Ritenour and Lipsky, plaintiff unsuccessfully sought to prove four separate causes of action under the theories of: (a) duress; (b) breach of obligations of full disclosure; (c) conspiracy to commit fraud and exert duress; and (d) violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Plaintiff has apparently dropped her claim relating to duress. Defendants Ritenour and Lipsky denied all liability and interposed the defenses of waiver, lack of due diligence and release.

After a trial without a jury, Judge Henry Werker decided (opinion at A31) on August 27, 1975, that defendants Ritenour and Lipsky were not liable to plaintiff under any of the claims alleged in the Complaint. Pepper was found to have failed to sustain *his* burden of proving full and fair disclosure to plaintiff, which obligation of disclosure arose out of the attorney-client relationship which existed between Pepper and plaintiff. An accounting was directed with respect to the amount of damages for which Pepper was liable. The suit was dismissed as to defendants Ritenour and Lipsky by entry of a judgment on September 30, 1975. Plaintiff appealed from that judgment.

The Facts

Modern Talking Picture Service, Inc. ("MTPS") was incorporated on July 23, 1937 (E102). Frank H. Arlinghaus was the President of MTPS from its incorporation to the time of his death and owned a majority of the outstanding shares of MTPS (E104). Mr. Arlinghaus brought Ritenour

into MTPS in 1946 and Lipsky in 1949 (Pre-Trial Order, hereinafter "PTO", p. 2). Ritenour and Lipsky achieved various promotions at MTPS (PTO 2-3) and when Teleservice was spun off in 1956 (E104) as a sister company to MTPS, Ritenour was made its President and Chief Executive Officer (A57) and Lipsky its Vice President (PTO3). Mr. Arlinghaus retained the title of Chairman of the Board until his demise (E108).

At the inception of Teleservice, a Voting Trust Agreement and "Buy-Back" Agreement (E71) were executed by all shareholders (See p. 5) of Teleservice (E104). Frank Arlinghaus was the voting trustee until his death (A61). The Buy-Back Agreement (E71) provided:

(a) that the remaining shareholders had an option to purchase shares of a deceased shareholder, unless within one year after the qualification of the executor or trustee there was a transfer to a trustee or to the immediate family of the deceased shareholder; and

(b) that the estate of a deceased shareholder could require Teleservice to purchase stock, which right was available for a period of three years from the date of death of the shareholder.

Defendant Pepper had performed substantially all of the legal work for MTPS (A135) and performed substantially all of the legal work for Teleservice (A58) after its inception (A136). He never represented either Ritenour or Lipsky.

In 1960 Frank Arlinghaus offered to sell all of the stock of Teleservice to Ritenour and Lipsky for $275,000 (A32, 255). By the time Ritenour and Lipsky managed to obtain the financing in 1961, they found that the price for the stock

had been increased by Mr. Arlinghaus to $350,000 (A256). Being unable to supply the additional amount of financing required, Ritenour and Lipsky proceeded to purchase shares of Teleservice from Mr. Arlinghaus in multiples of 7 shares each in 1962 and 1963 (PTO4). This was made possible by an amendment to the Buy-Back Agreement dated May 1, 1962 permitting transfers by shareholders to employees of Teleservice (E93). It was the understanding of Ritenour and Lipsky that their equity percentage in Teleservice would increase as the existing stockholders died and those shares were acquired by Teleservice, which in fact occurred (A260).

In August of 1964, more than 16 years after Ritenour and Lipsky first became associated with him, Frank Arlinghaus died (PTO1). Frank Arlinghaus' estate "faced a large tax assessment with little in the way of cash available to pay it." (A33). The Buy-Back expired in October 1966, except that the right to require Teleservice to purchase the shares in the estate of Frank Arlinghaus terminated in August 1967 (E89-90). Under the terms of the Buy-Back Agreement, plaintiff, as executrix of the estate could have required Teleservice to purchase the shares owned by the estate (A63) for a price of approximately $16 per share (A78). It was questionable as to whether Teleservice had the necessary funds to purchase all or part of the shares held by the estate (E110, 118), and any sale to Teleservice would result in only 28% of the price being paid in cash and the 72% balance in an unsecured promissory note of Teleservice payable over 48 months (E110). In any case, as a price of $20 was considered desirable (A63), and shares could only be sold to Teleservice at $16 per shares, in December of 1966, it was decided that plaintiff, as executrix would not offer the shares held in the estate to Teleservice under the Buy-Back Agreement (A65).

When Ritenour and Lipsky learned that there was no possibility that the estate shares would be purchased by Teleservice, they both realized that their desires and the desire of Frank Arlinghaus that they have an increased equity percentage in Teleservice would not be fulfilled (A263). At that point, in 1966, the board of directors of Teleservice "authorized Ritenour and Lipsky to look for a merger partner or purchaser" for Teleservice (A34) and Ritenour and Lipsky attempted to make other arrangements to acquire a greater interest in Teleservice (A264). "Several exploratory meetings were held with brokers. Ritenour routinely reported the fact and results of such meetings to the board of directors and to Pepper, as counsel to the Corporation and to the corporation's majority stockholder." (A34) These meetings led to Harris Shapiro ("Shapiro") a business broker who put together a group of people ("Syndicate") who agreed to finance the purchase of all of the stock of Teleservice (A265) at a price of $15 per share (A267). On April 25, 1967, Lipsky and Ritenour drafted an offer (E1) to all of the shareholders to purchase all of their shares of Teleservice at $15 per share. Pepper was in the Teleservice office and was asked if the language of Ritenour's draft was acceptable (R403).[1] The letter was mailed out to all of the shareholders. At that time, the shares of Teleservice were owned by the following (PTO 4):

Name	*Amount*	%
Frank Arlinghaus' Estate ..	20,360	34.6
Plaintiff, individually	4,000	6.8
Plaintiff, as custodian	8,400	14.3
William McCallum	8,400	14.3
Howard Eberle	7,000	11.9
Harry Bogaards	2,520	4.3
Ann Herles	5,460	9.3
Ritenour	1,540	2.6
Lipsky	700	1.2
Elsie Cox	420	.7
	58,800	100%

[1] R. refers to trial transcript.

All of the shareholders, except plaintiff and Howard Eberle[2] accepted the $15 offer (Exhibit E, p. 211; E.221, 223, 224, 225). A meeting was called which was held on May 10, 1967 at the Rockefeller Center Luncheon Club. In attendance at the meeting were plaintiff, Pepper, Clem Arlinghaus, Ritenour and Lipsky. Clem Arlinghaus was the brother of Frank Arlinghaus, was also a testamentary co-Trustee with plaintiff under the will of Frank Arlinghaus, and a member of the board of directors of Teleservice.

After hearing conflicting testimony as to what occurred at this first meeting, Judge Werker found "Ritenour's account of the discussion to be the most credible." (A36). Ritenour testified that at that meeting he had denied to plaintiff, Clem Arlinghaus and Pepper, the rumors that Ritenour and Lipsky would resign if plaintiff didn't sell her shares to them.

A second meeting occurred immediately after the luncheon meeting to determine possible responses to the $15 offer (A69, 70). This meeting took place in the lobby of the Rockefeller Center Building and was attended by plaintiff, Pepper and Clem Arlinghaus. Ritenour and Lipsky were not present. At this meeting, it was decided to make a counteroffer to sell for $20 a share to the Syndicate (A70) which price was agreed to by plaintiff (A196). The counteroffer was made and accepted by all shareholders and a closing was scheduled to take place on June 9, 1967 (A274). On June 9, the Syndicate was unable to obtain the required financing, the transaction did not close (A244, 274), and the Syndicate forfeited the $10,000 deposited initially as a downpayment. (Ex. 7, E54). On June 14, 1967, at a board

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[2] Eberle accepted provided that he got no less than anyone else.

meeting of Teleservice, the board authorized the retention of a financial consultant to aid in the sale of the assets or of the business of Teleservice (A244, 274).

On June 12, 1967 Ritenour met with a Mr. Stevenson in a further attempt to obtain outside financing (A244), which attempt also proved fruitless. Finally, Ritenour and Lipsky formulated a plan where each would purchase 15% of each shareholder's holding in Teleservice (A275). This was the total amount that they could afford. The plan was presented to Pepper as counsel for Teleservice and for plaintiff (A275-276). It is clear from all the testimony that Pepper's presence as a purchaser (through his wife) did not originate until June 9, 1967 at the earliest (A118, 275).

The final agreements evidencing plaintiff's sales to Ritenour, Lipsky and Pepper's wife were letters dated June 30, 1967 (E. 50, 53) and July 1, 1967 (E. 55, 57). Exhibit 8 (E55) is a letter agreement between Ritenour and plaintiff, individually which reflects that (a) plaintiff sold 4,000 shares at ten dollars a share; (b) if plaintiff, as executrix, "did not receive in cash or securities of a company listed on the New York Stock Exchange and acceptable to [plaintiff], at least the sum of $356,160.00 for the remaining 11,256 shares of [Teleservice] stock owned by [Frank Arlinghaus' estate] *and* in the case of each of [plaintiff's three custodian accounts for her children] $56,000 for 2,800 . . . prior to July 1, 1968" Ritenour would cause "the 4,000 shares presently sold by [plaintiff] to be made available to [plaintiff] for repurchases by [plaintiff] after July 1, 1968 and prior to August 1, 1968 on five days notice to [plaintiff], at the ten dollars ($10.00) a share sales price". In order to obtain $356,160 for the remaining 11,256 shares owned by Frank Arlinghaus' estate, such 11,256 shares would have to be sold at a price per share of $31.64. In order to obtain $412,160 ($356,160 plus $56,000)

for the remaining 14,056 shares (11,256 in the estate and 2,800 owned by plaintiff as custodian) such 14,056 shares would have to be sold at a price per share of $29.32. Plaintiff's handwritten notes (E189) clearly evidence the fact that plaintiff knew she had to receive $356,160 for the 11,256 shares remaining in Frank Arlinghaus' estate. Through September of 1967, some negotiations took place with respect to the purchase of the stock or assets of Teleservice, though it is clear from the evidence that no such negotiations resulted in any definitive offers or proposals. Up to September of 1967 the only definitive proposals for a sale of the Teleservice stock involved the following:

(a) A sale to Teleservice by the estate pursuant to the Buy-Back Agreement at a price of approximately $16 per share,

(b) A sale to the Syndicate for a negotiated price of $20 per share, and

(c) The sale that occurred from plaintiff to Ritenour and Lipsky and Pepper's wife at a price of $10 per share conditioned on a future sale of the balance of the shares held by the estate or by plaintiff as custodian at a price of at least $31.64 per share.

In the fall of 1967, an Agreement was signed (E6) whereby Fuqua Industries, Inc. would acquire the assets of Teleservice in exchange for shares of Fuqua. It has been speculated that the deal was worth to the Teleservice stockholders approximately $3.2 million (A235) or about $55 per share of Teleservice. In connection with this transaction, all of the stockholders including the plaintiff, signed a document relinquishing their rights to require Pepper's wife, Ritenour and Lipsky to sell back the shares at the original $10 purchase price (E61).

The Fuqua transaction was scheduled to close in April of 1968. It never closed because one of the conditions of the transaction relating to the earnings of Teleservice was not met (A284).

On April 22, 1968 an Agreement (E234) was executed providing for the acquisition of Teleservice by Sonderling (A286). Sonderling purchased the business of Teleservice for 130,000 Sonderling shares, 10,000 of which shares went to Shapiro as a business broker. The stockholders of Teleservice thus received a net consideration of 120,000 shares of Sonderling. Since at the time of the execution of the Sonderling Agreement, a share of Sonderling stock was worth approximately $26 (E63), the total consideration received by the Teleservice stockholders amounted to $3,120,000.

In May 1967 plaintiff owned of record and beneficially 32,760 Teleservice shares, all of which she was willing to sell to the Syndicate for $20 a share or an aggregate of $655,200. In June 1967, plaintiff received $131,040 for the conditional sale of a portion of the shares to the defendants. Upon the sale to Sonderling in April 1968 the plaintiff received 40,114 Sonderling shares (after deducting 3,343 shares which were distributed to the broker). The Sonderling shares received by plaintiff at the time of the exchange had a value of approximately $1.2 million. Therefore, plaintiff received cash and stock as of the closing of the Sonderling transaction of approximately $1,324,000. After receipt of the Sonderling stock, between August 1968 and May 1971, the plaintiff sold 57% of the Sonderling shares which she received for approximately $600,000 cash. As far as the record is concerned, plaintiff apparently retained ownership of approximately 17,249 shares of Sonderling stock she had received.

The following additional facts should be pointed out:

(1) Teleservice had 58,800 shares outstanding owned by eight shareholders. In 1967, plaintiff directly or indirectly owned 55.7% of the outstanding shares. Ritenour and Lipsky purchased 30% of the shares owned by each of the eight shareholders (A 277) for the same $10 a share price. None of the other stockholders have sued to rescind the sale of Teleservice stock.

(2) After the sale of Teleservice to Sonderling, the sister company, MTPS, was sold under circumstances leading (a) to the discharge of Pepper by plaintiff and (b) the litigation entitled *First National Bank of Cincinnati* v. *Pepper,* CA 75-7519. It is surmised that the hostility which arose between plaintiff and Pepper, as indicated in the opinion of Judge Frankel in *First National Bank of Cincinnati* v. *Pepper,* affected plaintiff's feelings toward Ritenour and Lipsky, though it is clear that Ritenour and Lipsky played no part in the *First National Bank of Cincinnati* case.

POINT I

All material information about Teleservice was known to plaintiff, either directly or indirectly.

A basic finding of the trial court in this case is that all material information about Teleservice was known to the plaintiff, either directly or indirectly. This finding is an integral and inseparable part of the facts in the case as set forth in this brief, and is amply supported by the record. References to the record are made in The Facts to support each fact stated.

The plaintiff, as the appellant, has the burden of proving on this appeal that the essential findings of the trial court are clearly erroneous. Not only has the appellant failed to prove that the findings of the trial court are clearly erroneous, but the appellant's brief presents practically no argument that the findings of fact of Judge Werker are erroneous, but erroneously attempts to argue that Judge Werker erred in applying the law of agency and federal securities law to these facts.

The defendant-appellees in this appeal, are Ritenour and Lipsky, laymen and corporate officers. Pepper, an unrelated party-defendant and an attorney who represented the plaintiff-appellant, is not a party to this appeal. However, plaintiff-appellant in her brief erroneously attempts to impose upon Ritenour and Lipsky the degree of fiduciary responsibility which Pepper, as attorney for the plaintiff, owed to his client. In her brief the plaintiff goes further and argues that Ritenour and Lipsky are liable for the acts and omissions of Pepper who was not their lawyer, but the lawyer for the plaintiff.

A. Trial Court Findings.

Based on all the evidence and after hearing the testimony of Clem Arlinghaus, plaintiff, Pepper, Ritenour and Lipsky, Judge Werker made the following findings of fact:

1. Clem Arlinghaus was plaintiff's brother-in-law and a member of the Teleservice board of directors (A32).

2. Pepper was the attorney for plaintiff and for Teleservice (A32).

3. After Frank Arlinghaus' death in 1964, his estate faced a large tax assessment with little in the way of cash available to pay it (A33).

4. In late 1967, plaintiff, Clem Arlinghaus and Pepper had several meetings at which it was agred that it would be desirable to sell the Teleservice stock at $20 per share (A33).

5. The Teleservice Board authorized Lipsky and Ritenour to look for a purchaser of Teleservice in 1966 (A34). Several exploratory meetings were held with brokers. Ritenour routinely reported the fact and results of such meetings to the Board, on which Clem Arlinghaus sat, and to Pepper, as the attorney for Teleservice and the plaintiff (A34).

6. Pepper knew of the Syndicate deal (A35).

7. With respect to the Syndicate, Pepper told Clem Arlinghaus that Ritenour and Lipsky were serious in their desire to purchase and had "adequate backing" to do so (A35).

8. Plaintiff, Clem Arlinghaus and Pepper decided to propose a $20 a share counteroffer to the Syndicate proposal (A36).

9. Plaintiff relied on Pepper and Clem Arlinghaus with respect to the Syndicate offer (A36-37).

10. Plaintiff's testimony that she didn't know of the Syndicate was not credible (A37).

Based on his findings of fact, Judge Werker found the following as conclusions of law:

1. Ritenour and Lipsky specifically denied the truth of any rumors of their resignation to plaintiff's face and, no more can be required of Ritenour and Lipsky after they instructed Pepper not to spread such rumors of resignation (A41).

2. Rather than conceal information on negotiations for the purchase of Teleservice, and the possible worth of Teleservice, Ritenour and Lipsky made routine reports on such matters to Pepper, as attorney for Teleservice and as attorney to plaintiff. Pepper's knowledge was imputable to plaintiff, for knowledge of the value of Teleservice was well within the scope of his agency (A41).

3. Once the $10 offer had been made, plaintiff was on notice that her attorney was also acting for a party on the other side of the transaction and therefore plaintiff is estopped from denying notice and knowledge which the agent had during the negotiation (A41-42).

"Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses". Federal Rules of Civil Procedure 52(a). Plaintiff, as appellant, has the burden of proving on this appeal that the essential findings of the trial court are clearly erroneous. *Hedger* v. *Reynolds,* 216 F. 2d 202 (2d Cir. 1954). The burden is a heavy one when the decision "must turn largely upon the credibility of witnesses the trial judge saw and heard testify". 216 F. 2d at 203. A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948).

This Circuit has held that where a trial judge sits without a jury and the evidence supporting a finding as to any fact issue is entirely oral testimony, that finding may be disturbed only in the most unusual circumstances. *Orvis* v. *Higgins,* 180 F. 2d 537, 539 (2d Cir. 1950), *cert. denied,* 340 U. S. 810 (1950).

B. Under the Circumstances of This Case, Even if There Had Been Disclosure Only to Pepper, Such Disclosure Would Have Been Sufficient.

Plaintiff's argument is that plaintiff could not be charged with the knowledge of and information relayed to her own attorney who's firm had represented her husband and his corporation for many years, and represented her as executrix and individually and as custodian for her children. The law of New York is clear that under the circumstances of this case, the plaintiff is clearly chargeable with the knowledge of her attorney.

1. Pepper Was Found Liable for Violating His Attorney-Client Fiduciary Relationship But Not for Fraud.

Plaintiff complains that Judge Werker misapplied the rule of the law of agency because no presumption that the agent will disclose to his principal can arise when the agent is "dealing with the principal's property for his own benefit and advantage" (p. 18, Plaintiff's brief). In this connection, plaintiff misconstrues the law of agency and fails to distinguish between actual fraud and presumptive fraud arising from breach of fiduciary duty on the part of an attorney. The cases cited by plaintiff to support her argument are cases where the agent perpetrated a fraud upon his principal. In the instant case, Pepper had a diversity of interest known to Ritenour and Lipsky as well as plaintiff. The conduct of Pepper, however, did not constitute fraud, nor did Judge Werker find any fraud.

Benedict v. *Arnoux*, 154 N.Y. 715 (1898), held that an agent's knowledge is not imputable to his principal when the agent is defrauding his principal. Judge Werker found Pepper liable for breach of Pepper's fiduciary duty (A42). Though Pepper was also found liable to plaintiff for "concealing from her the fact that negotiations for the sale of [Teleservice] indicated a probable corporate value of two to three million dollars" (A43), this last conclusion of law

was made by Judge Werker in light of finding Pepper to have failed to sustain his burden of proving that he disclosed every relevant fact to plaintiff, a burden arising as a result of the attorney-client relationship between Pepper and plaintiff. The New York Law is as follows:

> An attorney who seeks to avail himself of the benefit of a transaction with a client or to support the validity of such a transaction against attack has the burden of showing that it was fair and honest; that it was entered into by the client with knowledge of all the material circumstances; that it was free from fraud on the part of the attorney and misconception on the part of the client; that a reasonable use was made by the attorney of the confidence reposed in him; and that no unfair advantage was taken of the client. As soon as the confidential relation is shown, the court will presume in favor of the client that the transaction was not fair or was fraudulent. 3 *N.Y. Jur.*, Attorney-Client § 69.

Judge Werker found that *Pepper* had failed to sustain his burden as an attorney involved in a transaction with his client, and in accordance with the New York law quoted above, the transaction is presumed to be not fair or fraudulent (A43).

It is surprising that plaintiff cites *Farr* v. *Newman,* 14 N.Y. 2d 183, 250 N.Y.S. 2d 272 (1964), in support of her argument.

The court there stated as follows:

> If, under the substantive rules of equity and agency, actual knowledge by the principal is unnecessary, the presumption of communication [of agent

> to principal] becomes irrelevant. 14 N.Y. 2d at 188, 250 N.Y.S. 2d at 276.

The court then went on to state:

> When a prospective purchaser of real estate engages an attorney as his agent in the negotiations, he clothes the attorney with the incidental authority to receive in his behalf notice of outstanding equities. "If, under the circumstances known to him, the obvious consequence of the principal's own conduct in employing the agent is that the public understand him to have given the agent certain powers, he gives the agent those powers". (citation omitted), 14 N.Y. 2d at 189, 250 N.Y.S. 2d at 276.
>
> *A diversity of interest on the part of the agent is of no significance to third persons, such as plaintiff, unless it placed the agent's act beyond his authority.* Nothing can alter the fact that the attorney was held out as a proper person to whom notice of outstanding equities was to be given, and that his receipt of such notice from plaintiff was within his authority, both as actually conferred and as apparent to others. * * * Once the attorney received plaintiff's notification, as authorized by defendant, *even a fraudulent or self-serving concealment of that fact from the defendant* would no more extinguish plaintiff's protection than would a debtor's debt be revived where he had paid his creditor's authorized agent for collection who thereafter embezzled the money collected (citations omitted, italics supplied). 14 N.Y. 2d at 189-190, 250 N.Y.S. 2d at 277.

The court below found that "knowledge of the value of [Teleservice] was well within the scope of [Pepper's]

agency" (A41). The record supports this finding of fact and plaintiff does not dispute this. The creation, duration and scope of an agency relationship are essentially questions of fact: *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F. 2d 251 (4th Cir. 1974).

The New York Court of Appeals has also made a distinction between notice affirmatively given by a third party and notice acquired by an agent in the course of his investigations, and concluded that "[w]here as here, a party gives an agent notice, which, if given directly to the principal would have a certain legal effect, the principal is bound by that effect, the agent's adverse interest notwithstanding". 14 N.Y. 2d at 190, 250 N.Y.S. 2d at 277.

Finally, the New York Court of Appeals has made a distinction between an agent having a conflict of interest and an agent acting adversely to his client with the knowledge of the third party.

The court has stated as follows:

> A conflict of interest does not avoid the imputation of knowledge. Comment *c* under Section 282 [of the Restatement 2d of Agency] states in relevant part: "*c. Meaning of 'acting adversely'.* The mere fact that the agent's primary interests are not coincident with those of the principal does not prevent the latter from beng affected by the knowledge of the agent if the agent is acting for the principal's interests".
>
> It is only when no notice is given by the third party *and* the agent totally abandons his principal's business, as by taking a bribe from the grantor for his silence, that the principal is unaffected by the agent's knowledge. 14 N.Y. 2d at 190-191, 250 N.Y.S. 2d at 278 (emphasis in original).

2. Pepper's Interest and Activities Were Not Sufficient to Estop the Imputation of Pepper's Knowledge to Plaintiff.

The court found that Ritenour and Lipsky had denied rumors of their resignations to plaintiff, had enjoined Pepper from spreading any rumors of such resignation, and had dealt with Pepper solely as the attorney for plaintiff and for Teleservice.

Plaintiff insists that defendants Ritenour and Lipsky should have been on notice that Pepper would not fulfill his obligations to plaintiff because Pepper, through his wife, desired to purchase shares of Teleservice from plaintiff.

A contract between an attorney and his client is neither void nor voidable. "The public has a right to assume [an attorney] has the necessary legal knowledge to represent his clients and the integrity which will protect them from all fraud and wrongdoing on his part". *Spector* v. *Mermelstein,* 361 F. Supp. 30, 38 (S.D.N.Y. 1972), *aff'd in relevant part,* 485 F. 2d 474 (2d Cir. 1973). There is no allegation that any transaction involving an attorney and his client is, *per se,* illegal, and that any defect in such transactions should be known to a layman. The fact that some event is unusual, does not give rise to an inference of illegality. "A fact-finder may draw reasonable inferences from known or proven facts, but the inference must be based on common experience, be logical or be reasonable". *Miller* v. *Schweichart,* 1975-76 CCH Federal Securities Law Reporter Transfer Binder, ¶ 95,526, pp. 99, 693 (S.D.N.Y. 1976).

3. Rule 10b-5 Does Not Require Knowledge, Only Notice.

Plaintiff assumes that "the substantive rule of law requires knowledge and not simply notice . . ." (p. 21, Plaintiff's brief), without any citation for that statement.

It is clear from *Mittendorf* v. *J.R. Williston & Beane Inc.*, 372 F. Supp. 821 (S.D.N.Y. 1974) that notice is all that is required and not knowledge. This is further shown by the statement of this Circuit in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969):

> The essence of the Rule [10b-5] is that anyone who, trading for his own account in the securities of a corporatin has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information *knowing* it is unavailable to those with whom he is dealing. . . ." 401 F. 2d at 848 (Emphasis supplied).

4. Whatever Interest Pepper Had Arose After June 9, 1967.

In any event, plaintiff's argument is premised on Pepper's acquisition of an interest adverse to his principal. Plaintiff admits that Pepper told her of the threats of resignation no earlier than April of 1967 (A150). Furthermore, it is clear that Pepper's acquisition of an adverse interest did not begin earlier than June 9, 1967 (A118). Thus, any disclosure to Pepper prior to June 9, 1967 would be disclosure to plaintiff and there is no evidence of any negotiations or other material events which occurred after June 9, 1967.

5. Defendants Ritenour and Lipsky Did Not Intentionally Conceal Any Information.

Plaintiff's argument in the most favorable light, is at most, a charge of negligence for which no claim may lie. There is absolutely no proof of intent to conceal from plaintiff, the Teleservice board or anyone else. Since whatever

had to be disclosed was disclosed, at least to Pepper and the Teleservice board, there was no finding, and there could be no finding, of intent to deceive on the part of defendants Ritenour and Lipsky. Intent to defraud is an imperative element in a 10b-5 case, *Black* v. *Riker-Maxson Corp.*, 1975-76 CCH Federal Securities Law Reporter Transfer Binder, ¶ 95,270 (S.D.N.Y. 1975). It has been recently held by the Supreme Court of the United States that a private cause of action for damages will not lie under Section 10(b) and Rule 10b-5 in the absence of any allegation of "scienter", i.e., *intent to deceive, manipulate, or defraud on defendant's part. Ernst & Ernst* v. *Hochfelder*, U.S. , 47 L. Ed. 2d 668 (1976).

C. Plaintiff Knew or Should Have Known All Material Information From Sources Other Than Pepper.

Plaintiff sold her shares to defendants by letters dated June 30 and July 1, 1967. Plaintiff failed to introduce any offer or proposal, not known to her, which was known to any of the defendants prior to such date. Plaintiff knew of her right to require Teleservice to purchase her shares under the Buy-Back Agreement at approximately $16 per share which she rejected. She knew of the Syndicate offer of $15 a share, which she caused to be raised to $20 a share, and which she accepted, but which failed to materialize for lack of financing. Prior to June 30, 1967, all that was shown were that preliminary discussions were held with others without resulting in any concrete proposals, and that such negotiations were routinely reported to the board. Clem Arlinghaus sat on the board and called plaintiff after every board meeting.

It is clear that the proper date at which to determine the materiality of information is the date the parties become committed to one another. *Radiation Dynamics, Inc.*

v. *Goldmuntz,* 464 F. 2d 876 (2d Cir. 1972). "A party does not, within the intendment of Rule 10b-5, use material inside information unfairly when he fulfills contractual commitments which were incurred by him previous to his acquisition of that information, for . . . the Rule imposes 'no obligation to pull back from a commitment previously made by the buyer and accepted by the seller because of after acquired knowledge'." *Radiation Dynamics, Inc.* v. *Goldmuntz,* 464 F. 2d at 891.

POINT II

Plaintiff has failed to prove a material concealment.

It has been held that to sustain a violation under Section 10(b) and Rule 10b-5, the plaintiff must prove a misrepresentation or an omission which is material and is relied on. The basic test of materiality is "whether 'a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action of the transaction in question'. (citations omitted). Thus, to the requirement that the *individual plaintiff* must have acted upon the fact misrepresented, is added the parallel requirement that a *reasonable man* would have also acted upon the fact misrepresented". *List* v. *Fashion Park, Inc.,* 340 F. 2d 457, 462 (2d Cir. 1965), *cert. denied,* sub. nom., *List* v. *Lerner,* 381 U.S. 908 (1965). A major factor in determining whether events are material is the importance attached to them by those who knew about them. *SEC* v. *Texas Gulf Sulphur,* 401 F. 2d 833, 851 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969). "[W]hether facts are material within Rule 10(b)(5) when the facts relate to a particular event and are undisclosed by those persons who are knowledge-

able thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the Company activity''. *SEC* v. *Texas Gulf Sulphur,* 401 F. 2d at 849.

Courts ''will not extend the obligations imposed by Rule 10b-5 to include a duty to communicate verbally every fact conceivably relevant to a corporate acquisition where the complainant was made aware of such facts through other means or should have become aware thereof through a reasonable inspection of documents or other material made available during the course of negotiations''. *Caan* v. *Kane-Miller Corp.,* 1975-76 CCH Federal Securities Law Reporter Transfer Binder, ¶ 95,446 at page 99, 242 (S.D.N.Y. 1976).

Since there were no offers or proposals not disclosed to plaintiff, the plaintiff attempts to create liability on the part of defendants Ritenour and Lipsky because of their expertise and understanding of the field in which Teleservice was involved. An insider is not ''obligated to confer upon outside investors the benefit of his superior financial or other expert analysis by disclosing his educated guesses and predictions. (citations omitted). The only regulatory objective is that access to material information be enjoyed equally, but this objective requires nothing more than the disclosure of basic facts so that outsiders can draw upon their own evaluative expertise in reaching their own investment decisions with knowledge equal to that of the insiders.'' *SEC* v. *Texas Gulf Sulphur Co.,* 401 F. 2d at 848-49.

POINT III

Defendants Ritenour and Lipsky are not liable to plaintiff for any violation by Pepper of his fiduciary duties.

Since commencement of this suit, plaintiff has attempted (unsuccessfully) to create a conspiracy between Ritenour, Lipsky and Pepper. Having completely failed to establish a conspiracy at the trial level, plaintiff now, for the first time, introduces a new theory of liability, ostensibly one step removed from a conspiracy. Plaintiff now alleges Ritenour and Lipsky knowingly joined with Pepper in Pepper's breach of fiduciary duty.

Since this contention was not raised at the trial court, and rests upon the resolution of a sharply disputed question of fact, it may not be advanced on appeal. *See, e.g., Wilson* v. *Cook,* 327 U.S. 474, 66 S. Ct. 663, 90 L. Ed. 793 (1945).

In any event, plaintiff never introduced any evidence from which an inference could be drawn that Ritenour and Lipsky knew, or should have known, that material information, if any, not known to plaintiff but known to Pepper, was not disclosed by Pepper to plaintiff. Plaintiff again fails to discern a distinction between knowledge of Pepper's interest in the sale of shares by plaintiff, and knowledge of Pepper's breach of fiduciary duty.

POINT IV

Regardless of what disclosure was made by defendants Ritenour and Lipsky, directly or indirecty, to plaintiff, plaintiff's claim must fall because of the defenses of lack of due diligence, waiver and equitable estoppel.

A. Lack of Due Diligence.

The court below found that plaintiff had never sought an appraisal of the value of Teleservice. Plaintiff also testified that even after plaintiff had been put on notice of Pepper's adverse interest in the transaction in question, plaintiff never consulted Clem Arlinghous, her brother-in-law, who was on the board of directors, and as such, was in a position to fairly estimate the sales value of Teleservice (A45). "The general rule is that when a person has information or knowledge of certain extraneous facts, which of themselves do not amount to, nor tend to show, actual notice, but which are sufficient to put a reasonably prudent man upon an inquiry respecting an interest, claim or right, and the circumstances are such that the inquiry, if made and pursued with reasonable care and diligence, would lead to the discovery of the truth, then such person is absolutely charged with constructive notice of the interest, claim or right". 12 *Williston on Contracts*, § 1499A at P. 397 (3d Ed. 1970).

The Southern District has quoted with approval the following charge. "If you find from the evidence in this case that the plaintiff had knowledge of facts sufficient to excite its inquiry, and that the peculiar circumstances of this case were sufficient to impose upon the plaintiff a duty of reasonable diligence, and that the plaintiff failed to exercise this duty, then you should return a verdict for the defendants". *Caan* v. *Kane-Miller Corp., supra,* at page

99,243. It is clear that "the claimant's sophistication, expertise and business acumen, its access to information and opportunity to detect alleged fraud are all relevant considerations in determining the exercise of reasonable diligence". . . . "I am fully cognizant that the fundamental purpose of the federal securities laws is to substitute 'a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industries' (citations omitted). However, the securities laws are not to be used as an insurance policy for investors who choose voluntarily to disregard facts which would have been uncovered by any reasonable person in their position." *Caan* v. *Kane-Miller Corp.*, at P. 99, 242.

"In other words, whatever fairly puts a person on inquiry is sufficient notice where the means of knowledge are at hand; and if he fails to inquire, he is then chargeable with all of the facts which, by a proper and timely inquiry, he might have ascertained", 12 *Williston on Contracts*, § 1499A at P. 398 (3d Ed. 1970).

B. Waiver.

Plaintiff is suing for rescission. A defrauded party may lose his right of rescission by any act done after discovery of the fraud which indicates a willingness to allow the transaction to stand, such as the acceptance or demand of any benefit under the transaction, 12 *Williston on Contracts*, § 1527 at P. 626 (3d Ed. 1970). A party seeking rescission is "required to act with reasonable dispatch after it had either actual knowledge of fraud or notice of the facts which, in the exercise of due diligence, could have led to knowledge thereof". *Johns Hopkins University* v. *Hutton*, 488 F. 2d 912, 917 (4th Cir. 1973), *cert. denied*, 416 U.S. 916 (1974).

In this regard, plaintiff knew, or should have known, at the time of the Fuqua transaction, the possible value of the Teleservice shares she had sold to the defendants. The Fuqua deal would have placed a value on each Teleservice share of approximately $55. At the time that the Fuqua contract was executed, plaintiff released the defendants from the repurchase rights under the contract signed between the parties hereto (Exhibit 11, E 62) which would indicate "a willingness to allow the transaction to stand". Also, plaintiff waited almost a year before instituting this suit. Delay in instituting judicial prceedings for relief, although for a shorter period than that prescribed by the statute of limitations may be, and generally will be, regarded as an acquiescence. Rescission is a radical move and the law exacts the election of that course to be asserted without wait. *Pomeroy's Equity Jurisprudence,* (5th Ed. 1941) § 917.

Plaintiff remembered signing the release of repurchase rights (A158) and reading it at the time she signed it (A159). After the Sonderling deal, plaintiff did not complain to anyone about the sale to the defendants (A192). Plaintiff never made a demand on Ritenour or Lipsky until the suit was instituted in September 1968 (A194). Plaintiff never offered to return the original $10 per share purchase price to Ritenour or Lipsky (A195). In fact this suit was not instituted until problems arose between plaintiff and Pepper in connection with the sale of MTPS.

C. Equitable Estoppel.

Simply stated, the doctrine of equitable estoppel is that "where one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it". *Bunge Corp.* v. *Manufacturers Hanover Trust Company,* 31 N.Y. 2d 223, 228, 335 N.Y.S. 2d 412, 415 (1972). The principals which underline equitable estoppel place the loss upon the person whose

misplaced confidence has made the wrong possible, *National Safe Deposit Savings & Trust Co.* v. *Hibbs,* 229 U.S. 391, 397 (1912). If there is a loss to be sustained because of plaintiff's retention of Pepper, that loss should be borne by plaintiff.

CONCLUSION

The Court should affirm the judgment dismissing the action as to Messrs. Ritenour and Lipsky.

Respectfully submitted,

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